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# COMPENDIUM OF EVALUATION FINDINGS

## *ENDOWMENTS: A NEW APPROACH*

***Endowments can be used to strengthen and sustain the financial base of existing or new institutions and to transfer important development functions previously performed by the public sector. Endowments can perform effectively, but USAID must design effective safeguards that will shield them from uncertain and potentially perilous environments.***

## *Background*

Since the mid-1980s, a number of USAID Missions and host governments in Latin America and the Caribbean have collaborated in establishing and funding endowments. A USAID-funded endowment is frequently associated with a private, nonprofit organization that uses funds earned from the endowment to carry out development projects and programs. Local currencies generated by Economic Support Funds (ESF) and PL-480 food aid grants are the primary sources for funding endowments. The Debt-for-Development Initiative now allows U.S. dollar currency from Development Assistance funds and ESF to be used through debt swaps to fund endowments. Endowments can support a wide variety of development activities. USAID has helped establish endowments to support agricultural universities in Honduras, Costa Rica, and the Dominican Republic; agricultural research in Ecuador and Honduras; trade and investment promotion in Costa Rica; and agricultural policy analysis in Ecuador.

In an article in the December 1990 issue of *Innovative Development Approaches,* CDIE described USAID experience with endowments. Although Agency experience was too recent to be fully evaluated, the review did present some useful information and identify some possible management implications of the use of endowments. The article, "Terms of Endowment: A New USAID Approach to Institutional Development," serves as the basis for this summary; further CDIE examination of this approach is planned for 1994.

## *Findings*

• **Endowments are used to strengthen the financial base** of existing or new institutions, but can be much more than a financing device. USAID and the host government often use them to improve, if not restructure, vital development functions. Thus, they can achieve a public purpose through quasi-private means.

• **Endowed institutions deepen LDC organizational capacity** for development. As hybrid institutions, they enjoy a comparative advantage over public institutions because of their freestanding, independent status, and relatively stable funding base. They can thus perform special functions that neither the public nor private sector can effectively assume. In particular, some foundations perform tasks that require a high level of organizational entrepreneurship or the kind of flexibility and rapid problem-solving responses that most public sector organizations cannot mobilize.

• **Establishing an endowment requires familiarity with host country laws and regulations.** Since endowment investments must provide a stable source of interest earnings to finance operations and programs, care must be exercised to protect them from devaluation. In the early stages of an endowment, most or all of the resources may be required to be invested in government bonds. The ability of endowment managers to move the investment to a diversified, low-risk portfolio depends on the skill of USAID and the host government in building such flexibility into provisions governing the establishment and management of the endowment.

• **Use of memoranda of understanding or project agreements can help ensure accountability and integrity** of endowment governance and management. Establishing a separate board of trustees may be appropriate when the endowed organization is new and without a track record, or when the endowment is large. Standard provisions include the selection of a bank for a fiduciary account for the endowment funds and the selection of a securities trading company to manage the portfolio of investments. Both the depository bank and trading firm should be bonded. They should be selected in an open bidding process, usually with USAID involvement in the final selection process.

## *Recommendations*

• **Carefully consider potential displacement effects of the planned institution.** Endowed nongovernment organizations always run the risk of prompting a "brain drain" when, with their superior working conditions and higher salaries, they attract talented officials away from government agencies.

• **Design endowments to achieve financial viability but not complete security.** An organization that is forced over the long term to secure some of its resources in the marketplace appears to be less likely to turn inward, more likely to remain externally responsive.

• **Design strong governance mechanisms**, in particular the selection of a board of trustees or directors that is willing to exert a strong oversight role over the endowment. USAID should play a role in selecting the board members and, at least initially, should also have representation on the board.

• **Assign a tutelage or custodian role to an experienced outside contractor** who can assist a newly endowed organization in setting standards of performance and accountability in staffing and programming and in building constituency linkages.

• **Attract and financially reward** the best available leadership and staff. The presumed comparative advantage of an endowed organization is its ability to pay the higher salaries and benefits necessary to set and maintain standards of excellence and performance that would be difficult to match in the public sector.

• **Insist on a range of protective measures**, including annual audits by a reputable accounting firm selected on a competitive basis, with USAID as a voting member in the selection process. Contracts with auditors and custodian agents can be made subject to periodic review, if not termination and rebidding. Board members and other custodian agents may be required to file financial disclosure statements.

• **Insulate endowments from undue political interference**. Ensure that the endowed organization has a leadership that is politically astute and sensitive to government concerns. Co-opt important government agencies by including their representatives on the board of directors. Make use of experts who are highly knowledgeable of host country legal and financial regulations, as well as specialists who have international experience in designing endowments.

• **Facilitate portfolio diversification and protect the endowment from rapid devaluation and rampant inflation.** Possible provisions in the endowment agreement might include permission (after any LDC government-required period of investment in bonds) to move all or part of the original endowment into open market investments and to convert endowment resources into foreign currencies for offshore investments.

• **Consider carefully the current and possible future political climate in the host country.** Design effective safeguards to shield the endowment from an uncertain or perilous environment, so that it can pursue its intended objective with or without USAID's active presence in the country.

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